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CHARLES ELMO

IN THE

Supreme Court of the United States

OCTOBER TERM—1931.

No. 355.

FRANK COLLIS BOWERS, as Executor of the Estate of Frank K. Bowers, formerly United States Collector of Internal Revenue, deceased,

Petitioner,

—against—

LAWYERS MORTGAGE COMPANY,

Respondent.

BRIEF FOR RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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Opinions.

The opinion of the District Court is reported in 34 F. (2d) 504. The opinion of the Circuit Court of Appeals is reported in 50 F. (2d) 104.

Jurisdiction.

Jurisdiction of this Court is by virtue of Section 240 (a) of the Judicial Code, as stated in petitioner's brief.

Statement.

Petitioner's statement of the question presented and the facts is incomplete and inaccurate.

The question presented is whether the respondent was

exempt from capital stock tax under Section 1000 (b) of the Revenue Act of 1921, exempting from the tax "any insurance company subject to the tax imposed by section 243 or 246". The latter sections imposed income taxes, Section 243 on "every life insurance company", and Section 246 on "every insurance company (other than a life or mutual insurance company)", in lieu of the income tax and capital stock tax imposed upon business corporations generally by Sections 230 and 1000.

The respondent is a stock corporation, incorporated in 1893 as a mortgage and title insurance company, under Article V of the Insurance Law of the State of New York (R. 18, 39-40). It has operated in New York as an insurance company ever since (R. 19, 41), but has never engaged in title insurance (R. 22, 44). Prior to the amendment of the New York Insurance Law in 1913 (L. 1913, c. 215) and the amendment of respondent's charter accordingly (R. 18, 40), respondent's sole business was insuring the payment of outstanding mortgages owned by others, as the Circuit Court of Appeals pointed out (R. 147); and such business is still substantial in amount (R. 27, 49). This basic feature of respondent's business has been ignored by the petitioner in his statement of the question presented and in his argument. His only reference to it is the four-line statement at page 4 that such policies are issued "in a few cases"—a limitation not in accordance with the record.

In making mortgage loans and selling the mortgages with its insurance, as permitted by the 1913 amendments, the respondent makes no profit on the sales (R. 28, 49-50). Its primary purpose is the sale of the mortgages with its insurance, which *always* accompanies the sales (R. 28, 49-50).

ARGUMENT.

I.

The decision below was correct.

a. *Nature of respondent's business.*

Insurance of mortgages which the respondent never owned is unquestionably insurance business. After the 1913 amendments, investors wishing to invest in mortgages, with respondent's insurance, usually came directly to the respondent to obtain such mortgages, instead of making mortgage loans themselves and then insuring the mortgages with the respondent. The bulk of the respondent's business was accordingly done in that way, as a logical development which the amendment of the statute was undoubtedly intended to promote. It was none the less insurance, whether the respondent had previously owned the mortgages or not.

The figures quoted by the petitioner are misleading. In 1918, respondent's gross income from lending and extension fees was only $89,821, as against $299,162 interest on investments and $658,699 premiums (Exhibit M, R. 77). Commencing with the year 1921, there was a marked increase in building activity in New York and a corresponding increase in the demand for mortgage loans, especially building loans (R. 31, 52), the rates for which were higher (R. 29, 50-51). Those conditions explain the subsequent marked increase in the ratio of fees to other income.

b. *Mortgage insurance is recognized branch of insurance.*

Mortgage insurance is a well-recognized form of insurance, not only in New York, but in other States.

The People v. *Potts,* 264 Ill. 522.

It was recognized as such in the Revenue Act of 1918 (the immediate predecessor of the Revenue Act of 1921), which, in Title XI, Schedule A, subdivision 2, imposed a stamp tax "on all policies of guaranty and fidelity insurance, including * * * mortgage guarantee policies". Respondent paid stamp taxes on all its policies under that provision (R. 30, 52), regardless of whether it had previously owned the mortgages or not.

The hollowness of the petitioner's main argument, that mortgage insurance is not a commonly recognized form of insurance and should not be recognized in construing the 1921 Act, is evident, not only from such express recognition of mortgage insurance as such in the preceding Revenue Act, but also from the Treasury Department's admissions that the respondent was doing an insurance business (R. 77-78, 81, 134), before the present argument was thought of.

c. *The statute.*

The Revenue Act of 1921 segregated insurance companies (except mutual companies other than life) in imposing income taxes, and exempted them from capital stock taxes. The reason for the change was because, as the numerous cases in this Court have demonstrated, the statutory provisions imposing income tax on business corporations were difficult to apply to insurance

companies, on account of the special system of accounting required for such companies. The purpose of the change was to permit income taxes to be assessed upon the same general basis as the annual reports of insurance companies to the State Insurance Departments, as is shown by the references in the statute to the "annual statement approved by the National Convention of Insurance Commissioners" (*i. e.*, the forms prescribed by State Insurance Commissioners for such annual reports). It was not a statute of exemption; for the reports of both the Ways and Means Committee of the House and the Finance Committee of the Senate, when the bill was introduced, stated that the new tax (originally limited to life insurance companies only) would produce a larger revenue than the taxes replaced.[1]

d. *Respondent was clearly entitled to classification as an insurance company, under the statute.*

Respondent's business was a form of insurance generally recognized as such and taxed as such under the preceding Revenue Act. Being an insurance company filing annual reports under State law (R. 19, 41), it was within the obvious purpose of the statute. Moreover, in the absence of any statutory definition of the term, "insurance company", it must be construed as referring to insurance companies recognized as such under State laws.

United States v. *Loan & Bldg. Co.*, 278 U. S. 55.

In the case cited, the Treasury Department claimed

[1] 67th Cong., 1st Sess., House Report No. 350, p. 14; Senate Report No. 275, p. 20.

that a building and loan association organized and operating under the laws of Ohio was not entitled to the exemption from income tax granted to building and loan associations, since an analysis of its business showed that it was doing primarily a banking business. The reasons advanced for disregarding the State classification in that case were almost identical with those advanced in the present case; and they had much more support in the facts. Nevertheless, this Court held that the exemption should be construed as applying to building and loan associations recognized as such under State laws.

It is submitted that this decision is conclusive. In the present case, there are additional reasons why State classification should be adhered to. As just pointed out, the statute itself shows that Congress had State classification in mind. Moreover, under any arbitrary classification based upon an analysis of the business done, the status of many corporations would change from year to year for income tax purposes, and any orderly enforcement of the capital stock tax would have been absolutely impossible. That tax, as explained at length in the Treasury Regulations, was prospective, payable in advance on a return due in July for the privilege of doing business during the Government fiscal year from July 1 to the following June 30 (Regs. 64, Arts. 2, 14, 20), whereas income taxes were assessed on the calendar year basis. Obviously, no corporation could possibly determine in advance in July, when capital stock tax returns were due, whether its business for the remaining six months of that calendar year and the first six months of the following calendar year would result in its being classed as an insurance company for income tax purposes or not.

c. *For the foregoing reasons, the judgments of the lower courts were clearly correct.*

II.

No adequate ground for a review by this Court is shown.

None of the four reasons advanced by the petitioner for granting the writ is adequate.

1. Capital stock taxes were repealed in 1926 (Revenue Act of 1926, Sec. 1200a). They were comparatively small in amount ($1 per $1,000 of value of capital stock) and in themselves afford no ground for a review by this Court.

The differences in *income* taxation between insurance companies and other corporations, which have been retained in subsequent statutes, should, it is submitted, be reviewed only in a case where income taxes are in issue, so as to present clearly to this Court the differences in the two methods of income taxation. For example, the suggestion on page 10 of petitioner's brief that respondent's fees for making loans might escape income tax if the respondent were held to be an insurance company is a transparent argument *in terrorem*. No claim is made that the respondent has ever raised any such issue. On the contrary, respondent's income tax returns for 1921, 1922 and 1923 were introduced in evidence (Exhibits N, O and P) and show that the respondent voluntarily reported such fees as taxable income (R. 21-22, 43-44). As respondent's claims for refund of capital stock taxes were filed on November 14, 1923 (R. 20, 21, 42), four months before its income tax return for the year 1923, which was filed on March 15, 1924 (R. 22, 44), the record shows that the respondent

made no claim that such fees were not subject to income tax, in asserting its right to classification as an insurance company.

In stating on page 7 the large amounts of taxes involved in other cases as a ground for review, the petitioner fails to specify the nature of the cases. It is reasonable to assume that most of them are income tax cases, on which the decision of the present case would have at most only an indirect bearing; and from the second reason advanced by the petitioner (treated in the next paragraph), it may be inferred that cases involving stamp taxes are also included.

2. Whether guaranteed mortgage certificates are, or are not, subject to stamp tax as corporate securities obviously depends upon the form of the certificate and not upon the classification of the corporation which issues them. The certificates considered in *Mortgage Guarantee Co.* v. *Welch,* 38 F. (2d) 184, cert. den. 281 U. S. 759, were interest-bearing certificates secured by the deposit of some $22,000,000 of mortgages with a trust company. They thus differed in essential particulars from the form of guaranteed first mortgage certificate issued by the respondent (Exhibit U, R. 128-132), which assigns a specific undivided interest in a single, specified mortgage; but whether they, or the certificates of any other company, are or are not subject to stamp tax does not, it is submitted, depend in any way upon the decision of the present case.

3. Petitioner admits that there is no conflict of decisions of Circuit Courts of Appeals. Aside from the *Home Title Insurance Company* case (decided with the case at bar), petitioner is able to cite only two other

court decisions in point, although the statute was enacted in 1921. In both the latter cases cited, the companies involved were conducting separate departments of business outside the scope of ordinary mortgage and title insurance. The present cases are quite distinct, since both the *Home Title Insurance Company* and the respondent were doing only the usual form of mortgage and title insurance business.

4. As to the scope and effect of the decision of this Court in the *Cambridge Loan and Building Company* case, already discussed (*supra*, pp. 5-6), it is of course recognized that State laws are not conclusive in construing an Act of Congress. Where, however, Congress uses the term, "insurance company", without defining it, there are the same reasons for construing it with reference to State law that were applied by this Court in construing the term, "building and loan association". There are the additional reasons, already pointed out, why the statute should not be construed as requiring, or permitting, the Treasury Department to examine into the business of every corporation filing an income tax return and to determine arbitrarily, according to standards of its own, whether such corporation should, or should not, be classed as an insurance company.

III.

The petition should be denied.

Washington, D. C., September, 1931.

Respectfully submitted,

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